U.S. Direct Investment Abroad: Trends and Current Issues

James K. Jackson
Specialist in International Trade and Finance

July 28, 2010

Congressional Research Service
7-5700
www.crs.gov
RS21118

CRS Report for Congress
Prepared for Members and Committees of Congress

Summary

The United States is the largest investor abroad and the largest recipient of direct investment in the world. For some Americans, the national gains attributed to investing overseas are offset by such perceived losses as displaced U.S. workers and lower wages. Some observers believe U.S. firms invest abroad to avoid U.S. labor unions or high U.S. wages, however, 70% of U.S. foreign direct investment is concentrated in high income developed countries. Even more striking is the fact that the share of investment going to developing countries has fallen in recent years. Most economists conclude that direct investment abroad does not lead to fewer jobs or lower incomes overall for Americans and that the majority of jobs lost among U.S. manufacturing firms over the past decade reflect a broad restructuring of U.S. manufacturing industries.

Contents

Recent Investments 1
U.S. Multinationals 4
Employment 5
Conclusions 6

Figures

Figure 1. Foreign Direct Investment in the United States and U.S. Direct Investment Abroad, Annual Flows, 1990-2009 (in billions of dollars) 2

Tables

Table 1. U.S. Direct Investment Position Abroad on a Historical-Cost Basis at Year-End 2009 3

Contacts

Author Contact Information 7

Recent Investments

New spending by U.S. firms on businesses and real estate abroad, or U.S. direct investment abroad,[1] although substantial, fell by almost one-fourth in 2009 compared to 2008, reflecting the financial crisis and the economic downturn. Net investments fell from $351 billion in 2008 to $269 billion in 2009, according to the Department of Commerce.[2] A sharp drop in U.S. direct investment abroad that occurred in 2005 reflects actions by U.S. parent firms to reduce the amount of reinvested earnings going to their foreign affiliates for distribution to the U.S. parent firms in order to take advantage of one-time tax provisions in the American Jobs Creation Act of 2004 (P.L. 108-357).

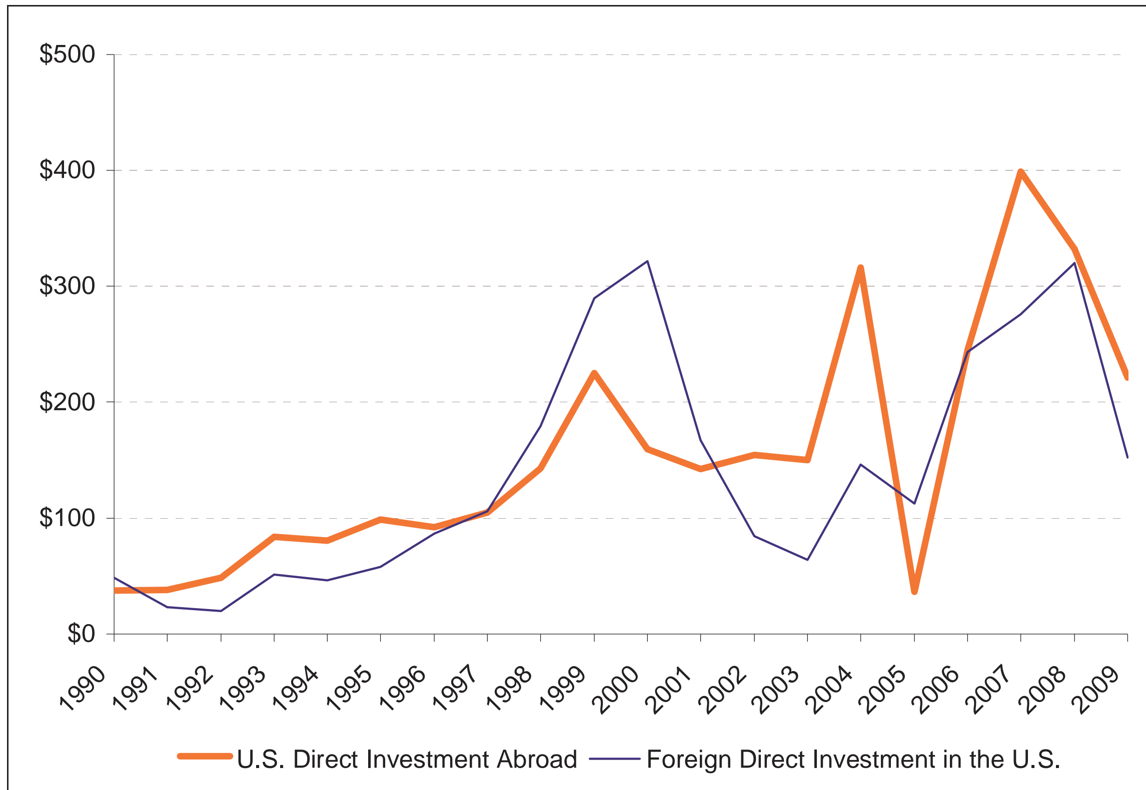
Generally, relative rates of growth between U.S. and foreign economies largely determine the direction and magnitude of direct investment flows. These flows also are affected by relative rates of inflation, interest rates, and expectations about the performance of national economies, which means they can be quite erratic at times. The drop in U.S. direct investment abroad in 2009 compared with 2008 reflected a sharp drop in equity capital, a turnaround in intercompany debt from positive to negative, a slight decrease in reinvested earnings arising from a decrease in distributed earnings. The sharp drop in stock market valuations around the world in 2008 devalued U.S. direct investment abroad, measured at market value, by $2.2 trillion. During the same period, the market value of foreign firms operating in the United states experienced a loss of over $1.0 trillion in 2008. In 2009, the recovery of foreign stock markets increased the value of U.S.-owned foreign securities by over $1 trillion, while the value of foreign-owned U.S. stocks rose by over $600 billion.

Since the mid-1990s, the combination of strong growth and low inflation in the U.S. economy has attracted foreign investors, as indicated in **Figure 1**. From 2002 to 2007, U.S. direct investment abroad averaged more than twice the amount foreigners invested in the U.S. economy, reflecting the period of slower growth in the economy from 2001-2003. In 2009, both U.S. and foreign direct investment dropped from the values of the previous year, but U.S. direct investment abroad was double the amount foreigners invested in U.S. businesses and real estate. Such investments way well pick up in the first half of 2010 as the rate of economic growth improves. On the whole, U.S. firms are the most prolific overseas investors: a recent study by the United Nations indicates that U.S. firms are the largest foreign direct investors in the world and own as much abroad as the British and Germans combined, the next largest foreign direct investors.

[1] The United States defines direct investment abroad as the ownership or control, directly or indirectly, by one person (individual, branch, partnership, association, government, etc.) of 10% or more of the voting securities of an incorporated business enterprise or an equivalent interest in an unincorporated business enterprise. 15 CFR § 806.15 (a)(1).

[2] Thomas, Sarah Scott, Erin M. Whitaker, and Daniel R. Yorgason, U.S. International Transactions: First Quarter 2010. *Survey of Current Business*, July 2010, p. 54. Direct investment data reported in the balance of payments differ from capital flow data reported elsewhere, because the balance of payments data have not been adjusted for current cost adjustments to earnings.

Figure 1. Foreign Direct Investment in the United States and U.S. Direct Investment Abroad, Annual Flows, 1990-2009 (in billions of dollars)



Source: U.S. Department of Commerce

Note: The drop in U.S. direct investment abroad in 2005 reflects actions by U.S. parent firms to reduce the amount of reinvested earnings going to their foreign affiliates for distribution to the U.S. parent firms in order to take advantage of one-time tax provisions in the American Jobs Creation Act of 2004 (P.L. 108-357).

Table 1 indicates that the overseas direct investment position of U.S. firms on a historical-cost basis,[3] or the cumulative amount at book value, reached $3.5 trillion in 2009, the latest year for such investment position data.[4] Slightly less than 70% of these overseas investments are in developed countries: Europe alone accounts for over half of all U.S. direct investment abroad, or $2 trillion. Europe has been a prime target of U.S. investment since U.S. firms first invested abroad in the 1860s. American firms began investing heavily in Europe following World War II as European countries rebuilt their economies and later when they formed an intra-European economic union.

[3] The position, or stock, is the net book value of U.S. parent company's equity in, and outstanding loans to, their affiliates abroad. A change in the position in a given year consists of three components: equity and intercompany inflows, reinvested earnings of incorporated affiliates, and valuation adjustments to account for changes in the value of financial assets. The Commerce Department also publishes data on the U.S. direct investment position valued on a current-cost and market value bases. These estimates indicate that U.S. direct investment abroad measured at current cost increased by $308 billion and rose by $1.2 trillion in 2009 when measured by market value, to reach $4.1 trillion and $4.3 trillion, respectively.

[4] Ibarra, Marilyn, and Jennifer Koncz, Direct Investment Positions for 2008: Country and Industry Detail, *Survey of Current Business*, July, 2009. p. 32.

Table 1. U.S. Direct Investment Position Abroad on a Historical-Cost Basis at Year-End 2009

(in billions of dollars)

	All industries	Manu-facturing	Whole-sale trade	Informa-tion	Banking	Finance	Services	Holding comp-anies	Other
All	**$3,508.1**	**$541.1**	**$199.0**	**$149.8**	**$114.0**	**$747.0**	**$77.5**	**$1,280.0**	**$228.7**
Canada	259.8	65.0	21.9	6.4	5.0	43.0	5.7	58.2	35.7
Europe	**1976.2**	**284.8**	**102.4**	**103.9**	**77.5**	**363.9**	**48.9**	**824.5**	**123.1**
Belgium	69.8	26.1	5.7	-0.6	(D)	31.5	1.7	2.6	(D)
France	85.8	28.1	5.6	2.5	4.5	6.1	2.8	25.8	10.2
Germany	116.8	31.8	10.6	4.0	1.7	17.3	6.4	36.7	8.4
Ireland	165.9	16.2	4.2	32.7	0.1	12.4	9.4	53.6	(D)
Italy	31.5	12.6	3.2	2.2	(D)	4.1	1.2	2.0	6.1
Luxemb.	174.1	8.3	0.0	6.0	(D)	37.6	0.1	115.2	(D)
Netherl.	471.6	30.7	19.8	12.7	(D)	50.4	5.7	331.6	(D)
Spain	50.6	15.0	3.5	0.8	2.4	5.0	0.5	20.1	3.2
Sweden	27.4	3.4	(D)	0.7	(D)	10.6	0.6	9.7	(D)
Switzer.	148.2	24.4	22.5	3.7	(D)	4.4	1.6	73.9	(D)
Turkey	6.3	1.6	1.9	-0.0	(D)	0.1	0.0	0.0	(D)
UK	471.4	53.4	14.6	36.7	17.4	173.5	16.7	114.3	39.4
LAmerica	**679.0**	**69.8**	**32.9**	**10.3**	**-13.0**	**220.3**	**2.3**	**286.7**	**29.8**
Brazil	56.7	25.6	2.1	3.6	3.9	11.2	0.7	6.3	0.3
Chile	22.6	2.7	0.8	0.1	1.5	3.8	0.3	0.8	(D)
Venez'	14.5	4.5	(D)	(D)	(D)	0.5	0.3	6.5	(D)
Mexico	97.9	24.4	3.0	3.0	1.9	15.9	0.4	32.4	11.6
Bermuda	245.7	1.8	6.4	0.8	(D)	98.1	0.3	133.3	7.1
Dom. Republic	1.0	0.6	(D)	(D)	-25.1	0.0	0.0	0.0	0.0
UK Car.	141.5	(D)	0.6	0.6	(D)	70.8	0.1	76.7	2.1
Africa	**44.8**	**3.6**	**1.3**	**0.2**	**2.2**	**2.4**	**0.4**	**7.8**	**1.9**
Middle East	**37.0**	**12.5**	**2.2**	**1.7**	**0.2**	**0.7**	**1.3**	**10.4**	**0.8**
Asia	**511.3**	**105.3**	**38.3**	**27.4**	**42.2**	**116.7**	**18.9**	**92.3**	**37.4**
Austral.	106.4	15.4	5.2	14.5	2.4	23.9	4.5	12.6	9.1
China	49.4	22.6	2.9	0.5	10.8	1.8	0.6	3.9	2.6
HK	50.4	4.4	8.3	1.5	3.3	13.6	3.3	13.3	2.7
Japan	103.6	16.9	8.2	5.0	(D)	49.9	2.4	8.3	(D)
Korea	27.0	10.9	2.2	0.5	(D)	4.2	0.4	(D)	(D)
Singapore	76.9	10.1	5.7	1.2	3.7	7.8	3.1	42.1	2.4

	All industries	Manu-facturing	Whole-sale trade	Informa-tion	Banking	Finance	Services	Holding comp-anies	Other
Taiwan	19.5	4.3	3.3	0.2	1.7	8.4	0.2	0.1	(D)
OPEC	56.0	11.1	2.0	0.2	(D)	1.0	1.2	21.0	(D)

Source: Ibarra, Marilyn, and Jennifer Koncz, Direct Investment Positions for 2009: Country and Industry Detail. *Survey of Current Business*, July 2010. p.32.

Note: A (D) indicates that the data have been suppressed by the Department of Commerce to avoid disclosing the data of individual companies.

Typically, U.S. firms have placed the largest share of their annual investments in developed countries, primarily in Western Europe, but this tendency has increased since the mid-1990s. In the last half of the 1990s, U.S. direct investment abroad experienced a dramatic shift from developing countries to the richest developed economies: the share of U.S. direct investment going to developing countries fell from 37% in 1996 to 21% in 2000. In 2009, U.S. firms focused a slightly smaller percent of their investment funds in Europe and Asia, while increasing their share of their investment spending in all other areas Canada. Developed countries received nearly 70% of the investment funds of U.S. multinational firms, while developing countries received about 30%.

Patterns in U.S. direct investment abroad generally reflect fundamental changes that occur in the U.S. economy during the same period. As investment funds in the U.S. economy shifted from extractive, processing, and manufacturing industries toward high technology services and financial industries, U.S. investment abroad mirrored these changes. As a result, U.S. direct investment abroad focused less on the extractive, processing, and basic manufacturing industries in developing countries and more on high technology, finance, and services industries located in highly-developed countries with advanced infrastructure and communications systems. The total amount of U.S. direct investment abroad, or the position, during the 2000-2009 period more than tripled, rising from $920 billion to $3.5 trillion. Investments in the banking, finance, and insurance sectors all fell in 2008, reflecting the financial crisis. Generally, service-oriented sectors continued to grow through 2008. Within the manufacturing sector, the direct investment position fell in most sectors in 2008, reflecting the economic recession that had started earlier in that year.

U.S. Multinationals

Nations once hostile to American direct investment now compete aggressively by offering incentives to U.S. firms. A debate continues within the United States, however, over the relative merits of U.S. direct investment abroad. Some Americans believe that U.S. direct investment abroad, directly or indirectly, shifts some jobs to low wage countries. They argue that such shifts reduce employment in the United States and increase imports, thereby affecting negatively both U.S. employment and economic growth. Economists generally believe that firms invest abroad because those firms possess some special process or product knowledge or because they possess special managerial abilities which give them an advantage over other firms. On the whole, U.S. firms invest abroad to serve the foreign local market, rather than to produce goods to export to the United States, although some firms do establish overseas operations to replace U.S. exports or

production, or to gain access to raw materials, cheap labor, or other markets. On average, about 8% of affiliate sales are to the U.S. parent companies.[5]

U.S. multinational corporations (MNCs) rank among the largest U.S. firms. According to data collected by the Commerce Department's Bureau of Economic Analysis (BEA), when American parent companies and their foreign affiliates are compared by the size structure of employment classes, 40% of the more than 2,000 U.S. parent companies employ more than 2,499 persons. These large parent firms account for 95% of the total number of people employed by U.S. MNCs. Employment abroad is even more concentrated among the largest foreign affiliates of U.S. parent firms: the largest 2% of the affiliates account for 90% of affiliate employment.[6]

While U.S. MNCs used their economic strengths to expand abroad between the 1980s and early 2000s, the U.S.-based parent firms lost market positions at home, in large part due to corporate downsizing efforts to improve profits. U.S. MNC parent companies' share of all U.S. business gross domestic product (GDP)—the broadest measure of economic activity—declined from 32% to 25% from 1977 to 1989.[7] In 2007 (the latest year for which estimates are available), U.S. parent companies accounted for about 21% of total U.S. business activity. These MNC parent companies accounted for about 41% of total U.S. manufacturing activity, down from 46% in 2000.

As U.S. MNC parent companies were losing their relative market positions at home, their cumulative amount of direct investment abroad doubled. This increase did spur a shift in some economic activity among the U.S. MNCs from the U.S. parent companies to the foreign affiliates. During the period from 2000 to 2007, the foreign affiliates increased their share of the total economic activity within U.S. MNCs—the combined economic output of the U.S. parent and the foreign affiliates—from 22% to 30%.[8]

Employment

One of the most commonly expressed concerns about U.S. direct investment abroad is that U.S. parent companies invest abroad in order to send low-wage jobs overseas. Such effects are difficult to measure because they are small compared with much larger changes occurring within the U.S. economy. In addition, a cursory examination of the data seems to indicate that employment losses among parent firms occurred simultaneously with gains in foreign subsidiaries, thereby giving the impression that jobs are being shifted abroad. Employment among U.S. parent companies fell during the early 1980s, but increased in the 1992-2000 period, from 17.5 million to 23.9 million. From 2000 to 2003, however, employment among U.S. parent companies fell by 12% to 21.1 million, before rising after 2003 to reach 22 million in 2007 as U.S. economic growth picked up. Employment among foreign affiliates also rose in 2007 by 4.0% to 10.0 million, from 9.6 million in 2006.

---

[5] *U.S. Direct Investment Abroad: Operations of U.S. Parent Companies and Their Foreign Affiliates, Preliminary 2004 Estimates*, October 2006. Table III. F. 1.

[6] Mataloni, Raymond J. Jr. U.S. Multinational Companies: Operations in 1998. *Survey of Current Business*, July 2000. pp. 24-45.

[7] Mataloni, Raymond J. Jr. U.S. Multinational Companies: Operations in 2003. *Survey of Current Business*, July 2005. p. 15.

[8] Ibid., p. 31.

After employment losses in the early 1980s, employment at both the parent firms and the foreign affiliates increased after 1992, although at different rates and in different industries. Both the U.S. parent companies and the foreign affiliates lost employment during the first part of the 2000s as the U.S. economy recovered from a period of slow growth. During such downturns, U.S. parent firms and their foreign affiliates often lose or gain employment in many of the same industries. Both the parent firms and the affiliates lost employment in the petroleum and finance sectors, although both gained employment in the services and wholesale trade sectors. Furthermore, employment gains and losses among MNCs more likely reflect fundamental shifts within the U.S. economy, than any formal or informal efforts to shift employment abroad.

Some observers also contend that U.S. direct investment abroad supplants U.S. exports, thereby worsening the U.S. trade deficit and eliminating some U.S. jobs. Most analyses indicate, however, that intra-company trade, or trade between the U.S. parent company and its foreign subsidiaries, represents a large share of U.S. trade and that foreign investment typically boosts U.S. exports more than it contributes to a rise in imports or to a loss of exports. For instance, American multinational corporations account for over 60% of U.S. exports and 40% of U.S. imports, indicating that U.S. parent firms tend to be a more important source of supply to their affiliates than the affiliates are to their parent companies.

Conclusions

American direct investment abroad has grown sharply since the mid-1990s, raising questions for many observers about the effects of such investment on the U.S. economy. These questions seem pertinent since American multinational corporations lost shares of U.S. GDP over the last decade and their domestic employment had declined until the mid-1990s. Increased economic activity abroad relative to that in the United States increased overseas affiliate employment in some industries, including manufacturing. Most of this affiliate activity, however, is geared toward supplying the local markets in which they are located. In 2004, 9.5% of the sales of the foreign affiliates of U.S. firms was accounted for by exports back to the United States,[9] although this share is nonetheless substantial.

Some observers believe U.S. direct investment abroad is harmful to U.S. workers because it shifts jobs abroad. There is no conclusive evidence in the data collected to date to indicate that current investment trends are substantially different from those of previous periods or that jobs are moving offshore at a rate that is significantly different from previous periods.[10] There are instances when firms shift activities abroad to take advantage of lower labor costs. However, it is clear from the data that the majority of U.S. direct investment abroad is in developed countries where wages, markets, industries, and consumers' tastes are similar to those in the United States. U.S. direct investment in these developed countries is oriented toward serving the markets where the affiliates are located and they tend, in the aggregate, to boost exports from the United States. In addition, foreign firms have been pouring record amounts of money into the United States to acquire existing U.S. firms, to expand existing subsidiaries, or to establish "greenfield" or new investments.

[9] Mataloni, Operations of U.S. Multinational Companies. p. 41.

[10] CRS Report RL32461, *Outsourcing and Insourcing Jobs in the U.S. Economy: Evidence Based on Foreign Investment Data*, by James K. Jackson.

Author Contact Information

James K. Jackson
Specialist in International Trade and Finance
jjackson@crs.loc.gov, 7-7751